

# Audit Report



REPORTING OF PERFORMANCE MEASURES IN THE DOD  
AGENCY-WIDE FINANCIAL STATEMENTS

Report No. D-2000-136

May 31, 2000

Office of the Inspector General  
Department of Defense

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### **Acronyms**

GPRA	Government Performance and Results Act of 1993
OMB	Office of Management and Budget
QDR	Quadrennial Defense Review
SFFAS	Statement of Federal Financial Accounting Standards
USD(Comptroller)	Under Secretary of Defense (Comptroller)



INSPECTOR GENERAL  
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May 31, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Audit Report on Reporting of Performance Measures in the DoD Agency-Wide Financial Statements (Report No. D-2000-136)

We are providing this report for review and comment. We conducted this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The Under Secretary of Defense (Comptroller) did not respond to the draft report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Under Secretary of Defense (Comptroller) provide comments on all recommendations by June 28, 2000.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Mr. Jack L. Armstrong at (317) 510-3846 (DSN 699-3846) (jarmstrong@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman", is positioned above the typed name.

Robert J. Lieberman  
Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. D-2000-136  
(Project No. OFI-2115.03)

May 31, 2000

### Reporting of Performance Measures in the DoD Agency-Wide Financial Statements

#### Executive Summary

**Introduction.** The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare annual audited financial statements. This is the second in a series of reports related to the DoD Agency-wide financial statements for FY 1999. The first report includes our disclaimer of opinion on the FY 1999 financial statements and discusses the adequacy of internal controls and compliance with laws and regulations for the financial statements.

The Government Performance and Results Act of 1993 established the requirement for strategic planning and performance measurement in the Federal Government. The Statement of Net Cost is intended to provide reliable and timely information on the full cost of Federal programs, activities, and outputs. The DoD Agency-wide Statement of Net Cost for FY 1999 reported total program costs of \$410.3 billion and total earned revenue of \$32.5 billion.

The Office of Management and Budget requires that the financial statement overviews and the Statement of Net Cost be consistent with performance goals and measures.

**Objectives.** Our overall audit objective was to determine whether the DoD Agency-wide financial statements were prepared in accordance with generally accepted accounting principles. As part of the objective, we reviewed the preparation of the DoD Agency-wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the "Overview" section of the DoD Agency-wide financial statements. We also reviewed the management control program as it related to the overall objective.

**Results.** The program categories used for the DoD Agency-wide and DoD Components' Statements of Net Cost were not consistent with the DoD performance goals and measures outlined in the DoD Government Performance and Results Act strategic and annual performance plans. The DoD form and content guidance incorrectly specified the use of appropriation categories, such as military personnel and operations and maintenance, as DoD programs. Consequently, the DoD Agency-wide Statement of Net Cost did not provide cost-of-operations data that were consistent with Government Performance and Results Act performance goals and measures. As a result, Congress, DoD managers, and other users of the DoD financial statements would not be able to compare net cost-of-operations data provided in the Statement of Net Cost with performance achievements and shortfalls (finding A).

The Overview section of the DoD Agency-wide financial statements did not clearly identify the Government Performance and Results Act performance measures relevant to DoD as a whole. Essential performance goals and measures, such as maintaining

airlift and sealift capability, were omitted from the Overview. In addition, no links existed between the financial data provided in the Statement of Net Cost, the DoD Components' performance measures and the DoD Agency-wide performance measures, and the Government-wide performance measures (finding B).

See Appendix A for details of the review of the management control program.

**Summary of Recommendations.** We recommend that the Under Secretary of Defense (Comptroller) develop consistent program categories, performance goals, and measures; modify DoD Regulation 7000.14-R, "DoD Financial Management Regulation," to specifically instruct preparers of the Statements of Net Cost to use consistent program cost elements with performance goals; include a discussion of requirements for managerial cost accounting systems capable of supporting performance measurement efforts in future versions of the DoD Financial Management Improvement Plan; and include a discussion of performance measures in the Overview section of future DoD Agency-wide financial statements.

**Management Comments.** We provided a draft of this report to the Office of the Under Secretary of Defense (Comptroller) on March 7, 2000, for comment and review. We did not receive comments on a draft of this report. We request that the Under Secretary of Defense (Comptroller) provide comments on the final report by June 28, 2000.

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## Background

This report is the second in a series of reports related to the DoD Agency-wide financial statements for FY 1999. This report discusses the preparation of the DoD Agency-wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the "Overview" section of the DoD Agency-wide financial statements. The first report includes our disclaimer of opinion on the FY 1999 financial statements and discusses the adequacy of internal controls and compliance with laws and regulations for the financial statements.

**Reporting Requirements.** Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, establishes the minimum requirements for audits of Federal financial statements.

**Accounting Functions and Responsibilities.** The Under Secretary of Defense (Comptroller) (USD[Comptroller]), as the Chief Financial Officer, is responsible for overseeing all financial management activities related to the programs and operations of DoD. As such, the USD (Comptroller) is responsible for compliance with laws and regulations applicable to the DoD Agency-wide financial statements. That responsibility includes determining whether those financial statements are prepared in accordance with Federal accounting standards and other reporting guidance.

The Defense Finance and Accounting Service performs accounting functions and prepares financial statements for DoD. The Defense Finance and Accounting Service operates under the control and direction of the USD(Comptroller). The Defense Finance and Accounting Service is responsible for entering information from DoD entities into finance and accounting systems, operating and maintaining the finance and accounting systems, and ensuring the continued integrity of the information entered. The DoD reporting entities are responsible for providing accurate financial information to the Defense Finance and Accounting Service through the data feeder systems. The data feeder systems contain the day-to-day operating information that needs to be translated into financial information and processed in finance and accounting systems to be useful for financial managers.

For FY 1999, the Defense Finance and Accounting Service was to prepare financial statements for nine OMB reporting entities: DoD Agency-wide; Army, Navy, and Air Force General Funds; Army, Navy, and Air Force Working Capital Funds; Army Corps of Engineers; and the DoD Military Retirement Fund. In addition, trial balance data were to be prepared for Other Defense Organizations for FY 1999.

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**DoD Agency-Wide Financial Statements.** The DoD Agency-wide financial statements consist of five parts: overview, principal statements, required supplementary stewardship information, required supplemental information, and other accompanying information. The principal statements for the nine reporting entities consist of six financial statements and related footnotes. The statements are the balance sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, the Statement of Financing, and the Statement of Custodial Activity. In response to the Government Performance and Results Act of 1993 (GPRA), OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998, and the DoD form and content guidance require that the overview and the Statement of Net Cost contain information consistent with GPRA performance goals and measures.

**GPRA Requirements.** GPRA provides for the establishment of strategic planning and performance measurement in the Federal Government. GPRA requires that each Federal agency prepare a strategic plan, annual performance plans, and reports. The Federal agencies' strategic plans were to be prepared and submitted to the Director, OMB, and to Congress no later than September 30, 1997. Although a Government-wide strategic plan is not required, GPRA does require a Government-wide performance plan for the overall Federal budget beginning with FY 1999. To support the Government-wide planning effort, each Federal agency must prepare an annual performance plan covering each program activity set forth in the budget of the agency. No later than March 31, 2000, and no later than March 31 of each year after that, the head of each agency is to prepare and submit to the President and Congress a report on program performance for the previous fiscal year.

The agencies' performance plans are to have established goals defining the level of performance to be achieved by a program. Specifically, the goals should be objective, quantifiable, and measurable. The performance indicators are to be used in the measurement and assessment of outputs and service levels of each agency's program. In the event an agency determines that expressing its goals in measurable, objective, and quantifiable terms is not feasible, an alternative form can be used. The use of an alternative form needs to be authorized by the Director, OMB. The alternative form must state the reasons for the impracticality of expressing performance goals in quantifiable, measurable, or objective terms. The alternative must contain such precise information about agency activity to allow for accurate, independent determination of agency performance. An agency may aggregate or segregate program activities except that the aggregation may not reduce the significance of the program activity.

**GPRA Strategic Plan.** The "Report of the Quadrennial Defense Review" (QDR Report), May 1997, serves as the overall strategic planning document for DoD. The QDR Report is intended to provide a blueprint for a strategy-based, balanced, and affordable Defense program. DoD designated the QDR Report to fulfill the GPRA strategic planning requirements. In addition, the Secretary of Defense issued a memorandum, "Department of Defense Government Performance and Results Act Mission Statement and Corporate



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Level Goals," June 23, 1997, describing how the QDR Report meets the GPRA strategic planning requirements. The Secretary's memorandum outlines the DoD mission statement, corporate-level goals, strategic objectives, and other GPRA requirements. Throughout this report, we refer to the QDR Report and the Secretary's memorandum as the QDR Report.

**GPRA Performance Plan.** DoD included its first annual performance plan, the GPRA performance plan for FY 1999, as an appendix to the "Annual Report to the President and Congress for 1998." The GPRA performance plan defines performance measures to support each of the corporate-level goals identified in the QDR Report. The performance report in the "Annual Report to the President and Congress for 1999" indicates the progress made toward meeting the key QDR Report corporate-level goals. The performance plan was refined in the GPRA performance plan for FY 2000. Additional information on DoD GPRA plans is discussed in Appendix B.

**GPRA Responsibilities in DoD.** Responsibility for GPRA is shared across organizational lines. However, the Office of the Under Secretary of Defense for Policy is responsible for preparing the overall DoD Strategic Plan. The Directorate for Program Analysis and Evaluation is responsible for the Performance Plan and Performance Report, and the Office of the USD (Comptroller) has general oversight for GPRA matters affecting all of DoD. In addition to the DoD-wide responsibilities, Secretaries of the Military Departments and the heads of the Defense agencies must develop, manage, and report on their strategic plans, goals, strategies, and performance measures. Those plans and goals must be linked to the corporate-level goals.

## Objectives

Our overall audit objective was to determine whether the DoD Agency-wide financial statements were prepared in accordance with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. As part of the objective, we reviewed the preparation of the DoD Agency-wide Statement of Net Cost and the reporting of performance measures in the Overview section of the DoD Agency-wide financial statements. We also reviewed the management control program as it related to the overall objective. Appendix A discusses the scope and methodology related to the audit objectives, and prior audit coverage.

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## **A. Statement of Net Cost and Performance Measures**

The program categories used for the DoD Agency-wide and DoD Components' Statements of Net Cost were not consistent with the DoD performance goals and measures outlined in the DoD GPRA strategic and annual performance plans. The DoD form and content guidance incorrectly specified the use of appropriation categories, such as military personnel and operations and maintenance. The appropriation categories were incorrectly specified because DoD did not do the following:

- identify the cost accounting information needed for DoD to establish program categories that were consistent with GPRA performance plans or
- have adequate managerial cost accounting systems in place to collect, process, and report operating costs.

As a result, the DoD Agency-wide and DoD Components' Statements of Net Cost did not provide cost-of-operations data that were consistent with GPRA performance goals and measures. Without future changes to reporting requirements, reliance on the financial statements would yield little useful information related to GPRA.

### **Program Cost Guidance**

The guidance for reporting program costs is presented in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Standards," July 31, 1995; OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998; and DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," October 6, 1999 (DoD Form and Content).

**Managerial Cost Accounting Standards.** SFFAS No. 4 requires Federal agencies to provide reliable and timely information on the full cost of Federal programs, activities, and outputs. The effective date for SFFAS No. 4 was FY 1998. SFFAS No. 4 states that managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. SFFAS No. 4 outlines the relationship between cost accounting, financial reporting in the Statement of Net Cost, and budgeting. SFFAS No. 4 states that cost information is essential for performance measurement; budgeting and cost control; determining reimbursements; and setting fees and prices, program evaluations, and economic choice decisions. SFFAS No. 4 further requires management of each reporting entity to define and establish responsibility segments. Such segments are functions or activities responsible for carrying out

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a mission, conducting a major line of activity, or producing one or a group of related products or services. The purposes of the segmentation are to determine and report the costs of services and products that each segment produces and delivers and to facilitate cost control and management.

**OMB DoD Financial Reporting Guidance.** OMB Bulletin No. 97-01 defines the form and content of financial statements that executive departments and agencies must submit to the Director, OMB, pursuant to the requirements of the Chief Financial Officers Act of 1990. OMB Bulletin No. 97-01 states the Statement of Net Cost is designed to show separately the components of the net cost of the reporting entity's operations for the period. The Statement of Net Cost shows the agencies' costs by responsibility segment or organizations and major programs. Because the organizational structure and operations of some entities are so complex, the guidance allows entities to display their suborganizations, major programs, and activities in supporting schedules in the notes to the financial statements. Those agencies preparing the Statement of Net Cost should decide the exact classification of suborganizations and programs based on the missions and outputs described in the entity's GPRA strategic and annual plans. Programs categorized on the Statement of Net Cost should include full costs of each program output that can be traced, assigned, or reasonably allocated.

**DoD Financial Reporting Guidance.** DoD Form and Content provides guidance on the form and content of DoD financial statements to be prepared under the authority of the Chief Financial Officers Act and OMB Bulletin No. 97-01. Chapter 5 of DoD Form and Content requires that the nine major appropriation groupings be used as program categories for the Statement of Net Cost.

## **Statement of Net Cost Programs**

The program categories used for the DoD Agency-wide and DoD Components' Statements of Net Cost and DoD performance goals and measures outlined in the DoD GPRA strategic and annual performance plans were not consistent with each other. As shown in Table 1, the program categories used for the Statement of Net Cost were not consistent with the DoD performance goals and measures. For example, the DoD Statement of Net Cost used Military Personnel and Operations and Maintenance as two of the program categories; however, the two categories were not GPRA performance goals or measures. On the other hand, the GPRA Performance Plan for FY 2000 provided the seven annual performance goals with measures such as the following:

- The plan listed the goal of supporting U.S. regional security alliances through military-to-military contacts and the routine presence of ready forces overseas, maintained at force levels determined by the QDR

Report. Examples of performance measures are Army overseas presence, Navy overseas presence, Air Force overseas presence, and Marine Corps overseas presence.

- Another goal of the plan was maintaining ready forces and ensuring that they have the training necessary to provide the United States with the ability to shape the international environment and respond to the full range of crises. Examples of performance measures are Army force levels, Navy force levels, Air Force force levels, Marine Corps force levels, and flying hours per month.

Table 1. Comparison of Statement of Net Cost Program Categories and GPRA Performance Goals and Measures	
Appropriation Categories Used in the Statement of Net Cost	GPRA Performance Goals That Should Be Used as Programs in the Statement of Net Cost
<ul style="list-style-type: none"> <li>• Military Personnel</li> <li>• Operations and Maintenance</li> <li>• Procurement</li> <li>• Research, Development, Testing, and Evaluation</li> <li>• Military Construction</li> <li>• Military Retirement Trust Fund</li> <li>• U.S. Army Corps of Engineers Civil Works</li> <li>• Working Capital Funds</li> <li>• Other Programs</li> </ul>	<ul style="list-style-type: none"> <li>• Overseas Presence</li> <li>• Maintaining Sufficient Airlift and Sealift Capability</li> <li>• Maintaining Ready Forces</li> <li>• Recruiting, Retention, and Developing Personnel</li> <li>• Transforming U.S. Forces for the Future</li> <li>• Streamlining the DoD Infrastructure</li> <li>• Improving the Efficiency of DoD's Acquisition Process</li> </ul>

Not only are the appropriation categories not consistent with DoD performance goals and measures, but the appropriation categories are inappropriate as program categories on the Statement of Net Cost. The Statement of Net Cost is intended to show the full net cost of operations for a reporting entity as a whole and its programs. Programs should include the full cost for program outputs and should consist of direct costs and other costs that could be directly traced, assigned, or reasonably allocated to the program. Program costs also include nonproduction costs that can be assigned. Costs assigned to the Statement of Net Cost are accrued expenses such as depreciation and year-end payroll expenses. Recording accrued expenses is not used in appropriation accounting. Therefore, using appropriations is inappropriate for program categories. An appropriation is a funding mechanism, and a program may use more than one appropriation. In addition, assigning meaningful performance measures to an appropriation would be difficult other than using obligation and spending rates as measures. A working group should sort out those cost issues to develop categories for the Statement of Net Cost that are consistent with GPRA performance goals and measures.

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The DoD Agency-wide Statement of Net Cost for FY 1999 identified total program costs of \$410.3 billion and total earned revenue of \$32.5 billion; however, the user of the financial statements could not discern or determine what it was costing DoD to achieve performance goals. The lack of meaningful information was a result of using appropriation categories as programs that did not meet the intent of SFFAS No. 4. SFFAS No. 4 requires that consistent cost data, drawn from a common source, support both performance measurement and financial reporting. OMB Bulletin No. 97-01 guidance requires that the programs featured in the Statement of Net Cost be consistent with the GPRA performance measures. Appendix B contains additional details on DoD corporate-level goals and performance goals and measures.

## **DoD Form and Content Guidance**

The DoD Form and Content guidance incorrectly specified the use of appropriation categories that led to the inconsistency between the DoD performance goals and measures and the program cost elements used in the Statement of Net Cost. The appropriation categories were incorrectly specified because DoD did not do the following:

- identify the cost accounting information needed for DoD to establish program categories that were consistent with GPRA performance plans, or
- have adequate managerial cost accounting systems in place to collect, process, and report operating costs.

**Management Cost Information Requirements.** DoD did not determine the cost accounting information needed to establish program categories that were consistent with DoD performance plans. USD (Comptroller) personnel informed us that they were in the process of studying the requirements for cost accounting information, but they did not identify the information that they needed to report costs by DoD performance goals and measures. Developing cost information requirements is also dependent on the adequacy of the DoD performance plan's goals and measures. The DoD financial and policy communities should coordinate and ensure that performance measures are structured so that costs can be collected or assigned.

**Performance Plan.** The General Accounting Office reported that the DoD performance plan was inadequate. The DoD FY 2000 annual performance plan provided a limited picture of intended performance across the Department and provided limited confidence that performance information was credible. Furthermore, the General Accounting Office stated that the DoD performance plan did not include information on how the Department was to qualitatively assess results, and goals and measures did not relate budget program activities to performance goals.



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**Coordination on Performance Goals and Measures.** Sharing the responsibility for GPRA across organizational lines contributed to the DoD problem in developing performance goals and measures that can be assigned costs. As previously stated, the Office of the Under Secretary of Defense for Policy is responsible for preparing the overall strategic plan for DoD; the Directorate for Program Analysis and Evaluation is responsible for the performance plan; and the Office of the USD (Comptroller) has general oversight for GPRA matters affecting all of DoD. In addition to the DoD-wide responsibilities, the Secretaries of the Military Departments and the heads of the Defense agencies must develop, manage, and report on their strategic plans, goals, strategies, and performance measures that are linked to the corporate-level goals.

In conjunction with representatives from the Office of the Under Secretary of Defense for Policy, Military Departments, and Defense agencies, the USD (Comptroller) should establish a working group. The working group should ensure that the performance goals and measures of DoD and program categories on the Statement of Net Cost are consistent and then should develop cost accounting requirements. After establishing the program categories, the USD (Comptroller) should modify the DoD Form and Content guidance to explicitly stress the need for consistency and links between the program cost element segments used in the Statement of Net Cost and the performance measurement structure.

**Managerial Cost Accounting Systems.** DoD was unable to comply with the requirements outlined in Federal accounting standards and other financial reporting guidance because it did not have adequate managerial cost accounting systems in place to collect, process, and report operating costs. The DoD Financial Management Improvement Plan, first published in FY 1998, acknowledges that the DoD managerial cost accounting system had several problems to overcome, which prevented effective cost management. One example is that DoD did not have adequate managerial cost accounting systems in place to track and report program costs by functional categories, such as systems engineering, program management, logistics, departmental assessments, test and evaluation, and acquisition of weapons systems hardware and software from prime contractors. However, the DoD Financial Management Improvement Plan did not discuss the details of the actions needed to correct the cost accounting deficiencies.

DoD must determine and define its cost accounting requirements before DoD can discuss details of actions needed to correct its deficient cost accounting systems. DoD management must know what it expects of its cost accounting systems before the corrective actions can be discussed in the DoD Financial Management Improvement Plan and actual solutions can be made to the cost accounting systems. Effective managerial cost accounting systems must provide consistent cost information from a common data source to support the needs shown in Table 2.

**Table 2: SFAS No. 4, Managerial Cost Accounting Needs**

- performance measurement
- budgeting and cost control
- determining reimbursements and setting fees and prices
- program evaluations
- economic choice decisions

The lack of effective managerial cost accounting systems limits the flexibility of DoD to perform traditional cost accounting functions, such as reporting costs by activity or program. Therefore, adequate managerial cost accounting systems, program categories, and performance goals and measures are interrelated. The USD(Comptroller) should ensure that any efforts in progress to develop a managerial cost accounting system include requirements that enable DoD to prepare Statements of Net Cost supporting performance measurement efforts. The USD(Comptroller) should also ensure that a discussion of the requirements is included in future versions of the DoD Financial Management Improvement Plan.

## **Conclusion**

The FY 1999 DoD Agency-wide and DoD Components' Statements of Net Cost did not provide cost-of-operations data consistent with GPRA performance goals and measures for DoD managers, OMB, Congress, and other financial statement users. Without future changes to reporting requirements, reliance on the financial statements would yield little useful information related to GPRA. The GPRA performance goals and measures and Statement of Net Cost programs are not meant to be mutually exclusive; they need to be reviewed together. Although DoD financial reporting has not yet been corrected to the point where meaningful comparisons of that type are possible, the structural problem identified in this report should be addressed in anticipation of accurate financial statements in the future.

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## **Recommendations**

A. We recommend that the Under Secretary of Defense (Comptroller):

1. Establish a working group as discussed in the section in this report on "DoD Form and Content Guidance" to develop program categories on the Statement of Net Cost and Government Performance and Results Act performance goals and measures that are consistent.

2. Modify DoD Regulation 7000.14-R, "DoD Financial Management Regulation," to specifically instruct preparers of the Statements of Net Cost to use consistent program elements based on the program categories developed pursuant to Recommendation A.1.

3. Include a discussion of requirements for managerial cost accounting systems capable of supporting performance measurement efforts in future versions of the DoD Financial Management Improvement Plan.

## **Management Comments Required**

The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. We request that the Under Secretary of Defense (Comptroller) provide comments on the final report.



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## **B. Reporting of Performance Measures in the Financial Statements**

The Overview section of the FY 1999 DoD Agency-wide financial statements did not adequately identify GPRA performance measures relevant to DoD as a whole. The Overview did not contain essential performance goals and measures such as maintaining airlift and sealift capability. The Overview section did not identify the measures because DoD did not fully comply with the financial reporting requirements outlined in OMB and DoD guidance related to reporting GPRA performance measures. Consequently, DoD managers, OMB, Congress, and other financial statement users did not have access to financial data provided in the Statement of Net Cost that was linked to the GPRA performance measures and which, in turn, are linked between the DoD Components' performance measures.

### **Guidance for Preparing the Overview**

Both OMB Bulletin No. 97-01 and the DoD Form and Content, chapter 3, guidance require that information on performance measures be discussed in the Overview section of agency financial statements. The Overview is the first part of the DoD financial statements. It should tell the reader what the mission of the entity is, how well the mission is being accomplished, and how to improve either financial or program performance. The performance measure information should be consistent with the performance measures that the agencies used as part of their GPRA performance plans. Performance measures identified in the Overview should also be consistent with the programs reported in the Statements of Net Cost. The Overview is to discuss the relationship of performance and financial information.

### **Financial Statement Overview**

The Overview section of the FY 1999 DoD Agency-wide financial statements did not adequately identify GPRA performance measures relevant to DoD as required by OMB Bulletin No. 97-01. The Overview discussed only two goals: to reduce the number of noncompliant accounting and finance systems and to achieve favorable audit opinions on the financial statements. The financial management improvement goals were included in the FY 2001 performance plan (see Appendix B) but were not in the FY 2000 plan. However, the Overview did not discuss the two DoD corporate-level goals and seven performance goals contained in the FY 2000 DoD GPRA performance plan as required by OMB Bulletin No. 97-01.

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The Overview section did not identify all the measures because DoD did not fully comply with the financial reporting requirements outlined in OMB and DoD guidance related to reporting GPRA performance measures. Based on the link between the Government-wide performance plan and the Federal agencies' plans, each Federal agency's plans would be based on the plans of its components. Eventually all performance measures would be incorporated in the Government-wide goals. Because DoD did not provide adequate performance measures in the Overview section of the DoD Agency-wide financial statements, that link did not exist for DoD. The information contained in the DoD Agency-wide financial statements and the GPRA performance plan are of minimal use if they are treated as stand-alone documents.

## **Performance Measures**

The Overview discussion of goals and performance measures is to define the level of performance to be achieved by a program element. The DoD Agency-wide overview should have discussed the GPRA performance measures and should summarize the performance measure discussions contained in the DoD Component financial statements. The performance indicators were to be used to assess the outputs, deficiencies, or service levels of each agency's program. The discussion should provide DoD managers, OMB, Congress, and other financial statement users with information on the progress that DoD is making toward meeting its GPRA goals. The Overview discussion should also serve as the link between financial data provided in the Statement of Net Cost and the GPRA performance measures. The Army, Navy, and Air Force General Fund and the Army, Navy, Air Force, and Defense Logistics Agency Working Capital Fund financial statement overviews included discussions of common performance measures that were not included in the DoD Agency-wide financial statements.

**General Funds.** The overviews in the Army, Navy, and Air Force financial statements addressed many of the GPRA performance goals and measures discussed in Appendix B. The performance goals and measures were addressed in the GPRA performance plan for FY 2000. Table 3 shows examples of the performance goals.

**Table 3. Examples of Performance Goals**

- Maintaining sufficient airlift and sealift capability, with adequate propositioning, to move military forces from the United States to any location in the world.
- Transforming U.S. forces for the future.
- Streamlining the DoD infrastructure by redesigning the Department's support structure and pursuing business practice reforms.

Although the performance goals and measures are critical to the mission of DoD, they were not addressed in the DoD Agency-wide overview to link the DoD Agency-wide financial statements to performance measures such as "Readiness" or other major categories.

**Working Capital Funds.** The overview of the four working capital fund financial statements discussed common performance measures, to include operational efficiency improvements, information system improvements, net operating results, and unfunded depot maintenance requirements. For example, the unfunded depot maintenance requirements and net operating results are specific performance measures addressed in the DoD performance plan. DoD established a performance indicator to reduce the amount of unfunded depot maintenance of more than \$862 million for the Army, the Navy, and the Air Force by FY 2000.

The "net operating results" is an important performance indicator common to all working capital funds and should have been addressed in the overview. The net operating results is the difference between an individual fund's revenue and its costs. A high net operating result indicates that a fund exceeded expectations. Conversely, a low net operating result (or an operating loss) may indicate low efficiency. The indicator is particularly important to DoD managers, such as the FY 2000 net operating results projected to be a loss of \$155.3 million for the U.S. Transportation Command and \$45.5 million for the Air Force Depot Maintenance business area. Despite the obvious connection to the budget category, the unfunded depot maintenance and net operating results were not directly linked to the budget categories (Working Capital Fund) used in the DoD Agency-wide Statement of Net Cost or to the performance measures published in the DoD GPRA plan.

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## **Conclusion**

The Overview for the FY 1999 DoD Agency-Wide financial statements discussed two financial management improvement performance goals. However, those goals related to the performance goals for FY 2001 and did not link financial performance with the two corporate-level goals and the other mission related performance goals. DoD managers and other financial statement users were not provided the relationship between financial data provided in the Statement of Net Cost and the GPRA performance goals and measures. More importantly, DoD managers, OMB, Congress, and other financial statement users were not provided the link between the DoD Components' performance measures, the DoD Agency-wide performance measures, and the Government-wide performance measures.

## **Recommendation**

B. We recommend that the Under Secretary of Defense (Comptroller) include performance measures, consistent with those provided in the DoD Government Performance and Results Act performance plan, and relevant to DoD as a whole, in the Overview section of the DoD Agency-wide financial statements.

## **Management Comments Required**

The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. We request that the Under Secretary of Defense (Comptroller) provide comments on the final report.

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## Appendix A. Audit Process

### Scope

As part of our effort to determine whether the DoD Agency-wide financial statements were presented fairly in accordance with OMB Bulletin No. 97-01, we reviewed the preparation and presentation of the DoD Agency-wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the Overview section of the DoD Agency-wide financial statements. The purpose of this audit was not to address the quality or adequacy of the DoD strategic and performance plans, nor the adequacy of the DoD goals, objectives, and performance measures contained in the plans.

The DoD Agency-wide Statement of Net Cost for FY 1999 identified total program costs of \$410.3 billion and total earned revenue of \$32.5 billion for a total net cost-of-operations of \$377.8 billion. In addition, DoD reported total assets of \$599 billion, total liabilities of \$999 billion, and total budgetary resources of \$628 billion. The total DoD assets did not include assets identified as National Defense property, plant, and equipment. National Defense property, plant, and equipment assets were included as supplementary stewardship information in the financial statements.

**DoD-Wide Corporate-Level Government Performance and Results Act Goals.** In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. (01-DoD-2.5)

**DoD Functional Area Reform Goals.** Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal:

- **Financial Management Area.** Objective: Strengthen internal controls. Goal: Improve compliance with the Federal Managers' Financial Integrity Act. (FM-5.3)

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

We have revised the GPRA performance goals addressed in this section to reflect the DoD revised performance plan for FY 2001. Findings A and B and

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## Methodology

We reviewed the Government Performance and Results Act of 1993 and OMB Circular No. A-11, "Preparation and Submitting Budget Estimates," which provides Federal agencies with guidance for preparing GPRA strategic and annual performance plans. We reviewed SFFAS No. 4, which provides Federal agencies with guidance on defining responsibility segments and implementing a managerial cost accounting system. We reviewed OMB Bulletin No. 97-01 and DoD Form and Content guidance, which provide guidance and requirements for preparing the Statements of Net Cost and reporting performance measures in the Overview section of the DoD Agency-wide and DoD Components' financial statements for FYs 1998 and 1999. We reviewed the DoD GPRA plans, the Quadrennial Defense Review Report (strategic plan) and the GPRA performance plans for FY 1999 and FY 2000 (annual performance plan) to identify DoD corporate-level goals and performance measures.

We analyzed the DoD Agency-wide and DoD Components' Statements of Net Cost to determine whether the responsibility segments used in their preparation were consistent with the performance measurement structure, including the corporate-level goals and performance measures, identified in DoD GPRA performance plans. We reviewed the Overview section of the DoD Agency-wide and the DoD Components' financial statements to determine whether performance measures related to the reporting entities were identified and discussed as required by OMB Bulletin No. 97-01 and DoD Form and Content guidance. We conducted interviews with USD (Comptroller) personnel regarding the preparation of the DoD Agency-wide and DoD Components' financial statements, the preparation of the GPRA performance, and the designation of the QDR Report as the DoD strategic plan.

**Accounting Principles.** Accounting principles and standards for the Federal Government have been established and are under continuous development and refinement.

The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards for approval by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. The Director, OMB, and the Comptroller General issue the standards after approving them.

Agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01. The hierarchy includes standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. The hierarchy also includes interpretations of SFFAS issued by OMB, requirements for the form and content of financial statements outlined in OMB Bulletin No. 97-01, and accounting principles published by other authoritative sources.

**Computer-Processed Data.** We did not rely on computer-processed data as the basis for conclusions developed in this report.

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**Audit Type, Period, and Standards.** We performed this financial-related audit from February through December 1999. We conducted this audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls as we considered necessary.

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD. Further details are available on request.

## **Management Control Program**

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of Review of Management Control Program.** As part of our overall objective to determine whether the DoD Agency-wide financial statements were presented fairly, we also reviewed the adequacy of management controls, which included the management control program, related to the preparation of the DoD Agency-wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the Overview section of the DoD Agency-wide financial statements. We also reviewed management's self-evaluation applicable to those controls.

**Adequacy of Management Controls.** We identified material management control weaknesses for the USD(Comptroller) as defined by DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. The management controls were deficient over the preparation of the DoD Agency-wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the Overview section of the DoD Agency-wide financial statements. Recommendations A.2., A.3., and B. made in this report, if implemented, will improve the management controls. A copy of the report will be provided to the senior official responsible for management controls in DoD.

**Adequacy of Management's Self-Evaluation.** The USD(Comptroller) acknowledged in its Management Representation Letter for the DoD Agency-wide financial statements for FY 1999 that the financial statements may not be presented in full conformity with Federal accounting standards. Also, management reported the lack of adequate cost accounting systems as an internal control deficiency in the FY 1998 DoD Biennial Financial Management Improvement Plan.

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## Summary of Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. and Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>. The Naval Audit Service issued one report related to the objective, Report No. 060-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Statement of Net Cost and Required Supplemental Stewardship Information," September 14, 1999. The Air Force Audit Agency issued one report related to the objective of this report, Project No. 98053004, "Managerial Cost Accounting and the Statement of Net Cost, Fiscal Year 1998," September 24, 1999.



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## **Appendix B. DoD Mission Statement, and Government Performance and Results Act Performance Goals and Measures**

### **DoD Mission Statement**

The mission of the Department of Defense is to support and defend the Constitution of the United States; to provide for the common defense of the United States, its citizens, and its allies; and to protect and advance the U.S. interests around the world.

### **DoD Performance Goals and Measures**

The GPRA performance plan for FY 2000 provides the seven performance goals with measures relevant to each of the two corporate-level goals.

1. Corporate-Level Goal 1. Shape the international environment and respond to the full spectrum of crises by providing appropriately sized, positioned, and mobile forces. Annual performance goals include the following:
  - Supporting U.S. regional security alliances through military-to-military contacts and the routine presence of ready forces overseas, maintained at force levels determined by the Quadrennial Defense Review. Examples of performance measures are Army overseas presence, Navy overseas presence, Air Force overseas presence, and Marine Corps overseas presence.
  - Maintaining ready forces and ensuring that they have the training necessary to provide the United States with the ability to shape the international security environment and respond to the full range of crises. Examples of performance measures are Army force levels, Navy force levels, Air Force force levels, Marine Corps force levels, and flying hours per month.
  - Maintaining sufficient airlift and sealift capability, with adequate propositioning, to move military forces from the United States to any location in the world. Examples of performance measures are intertheater airlift capacity and surge sealift capacity.
2. Corporate-Level Goal 2. Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the

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Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. Annual performance goals include the following:

- Recruiting, retaining, and developing personnel to maintain a highly skilled and motivated force capable of meeting tomorrow's challenges. Examples of performance measures are enlistment recruiting and enlisted retention rates.
- Transforming U.S. forces for the future. Examples of performance measures are annual procurement spending and joint service experiments.
- Streamlining the DoD infrastructure by redesigning the Department's support structure and pursuing business practice reforms. Examples of performance measures are percentage of DoD budget spent on infrastructure, unfunded depot maintenance requirements, logistics response time, and Defense Working Capital Funds net operating results.
- Meeting combat forces' needs smarter and faster with products and services that work better and costs less, by improving the efficiency of the DoD acquisition process. Examples of performance measures are major acquisition program cost growth, major acquisition program cycle time, and percentage of paperless transactions.

## Revised Performance Goals

The DoD revised its performance plan for FY 2001. DoD added to the performance plan three performance goals related to improving financial and information management.

- Streamline the Department's accounting and finance systems. The performance measure is the reduction of the number of noncompliant accounting and finance systems.
- Obtain unqualified audit opinions on the Department's financial statements.
- Reform the information technology management process to increase its efficiency and enhance its contribution to the DoD mission.

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Policy  
Under Secretary of Defense (Comptroller)  
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    Deputy Comptroller (Program/Budget)  
    Director, Program Analysis and Evaluation  
Director, Defense Logistics Studies Information Exchange

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Finance and Accounting Service  
Director, Defense Logistics Agency  
Director, National Security Agency  
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Office of Management and Budget  
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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
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Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Management, Information, and Technology,  
Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International  
Relations, Committee on Government Reform

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